Franchise Tax Board

ANALYSIS OF ORIGINAL BILL

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Related Bills: See Legislative History | Telephone: 845-4786 | Introduced Date: 02/23/2000

Attorney: Patrick Kusiak | Sponsor:

SUBJECT: Zero-Emission Vehicle Credit

SUMMARY

Under the Personal Income Tax Law (PITL) and the Bank and Corporation Tax Law (B&CTL), this bill would provide a credit equal to an unspecified percentage of the amount paid or incurred to lease or purchase a new zero-emission vehicle (ZEV), with a $3,000 per vehicle annual credit limitation.

EFFECTIVE DATE

As a tax levy, this bill would be effective immediately upon enactment. This bill specifies that it would apply to taxable and income years beginning on or after January 1, 2001, and before January 1, 2006.

LEGISLATIVE HISTORY

AB 3322 (95/96) proposed an ultra low-emission or zero-emission vehicle credit and failed passage in the Assembly Revenue and Taxation Committee. SB 751 (95/96) proposed a similar ultra low-emission or zero-emission vehicle credit and failed passage in the Senate Appropriations Committee.

PROGRAM HISTORY/BACKGROUND

Prior state law, in effect for taxable or income years beginning on or after January 1, 1991, and before January 1, 1996, allowed a credit equal to 55% of the qualified costs paid or incurred for low-emission motor vehicles or low-emission conversion devices. ZEVs were included in vehicles eligible for the credit. The California Energy Commission was responsible for allocating an annual maximum aggregate amount of $750,000 to all taxpayers. Qualified costs included:

1) the cost of retrofitting an existing motor vehicle to operate on low-emission fuel;
2) the differential cost between purchasing a new low-emission motor vehicle and a comparable vehicle that was not a low-emission vehicle (as certified by the State Air Resources Board); or
3) 15% of the purchase price of a qualified nonrecreational motor vehicle.

Any unused credit could be carried forward. The credit was required to be reduced by the amount of any federal credit claimed for the cost of retrofitting devices.

Board Position:

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Department Director	Date
Alan Hunter for GHG	3/28/00

SPECIFIC FINDINGS

For property placed in service after June 30, 1993, and before January 1, 2005, **federal law** allows a deduction from gross income for part of the cost of any qualified clean-fuel vehicle or qualified clean-fuel vehicle refueling property in the taxable year in which the property is first placed in service by its original owner. For purposes of this deduction, a motor vehicle is defined as a self-propelled vehicle manufactured primarily for use on public streets, roads, and highways and having at least four wheels. The maximum deduction is limited based on the vehicle's gross weight and the type of vehicle. Electric vehicles are excluded.

Taxpayers must reduce their federal adjusted basis for depreciation purposes in the clean-fuel vehicle by the amount of the deduction claimed.

Under **federal law,** the deduction for qualified clean-fuel vehicle refueling property cannot exceed certain aggregate amounts per location. The deduction is not allowed for property used primarily outside the United States or by certain tax-exempt entities or foreign persons or for costs of eligible personal or qualifying property deducted under IRC Section 179.

Also under federal law effective June 30, 1993, taxpayers may, for property placed in service after June 30, 1993, and before January 1, 2005, claim a credit of up to 10% of the cost of purchasing a qualified electric vehicle, to a maximum credit of $4,000 per vehicle. A qualified electric vehicle is defined as any motor vehicle powered primarily by an electric motor drawing current from rechargeable batteries, fuel cells, or other portable sources of electric current. Taxpayers must offset the federal adjusted basis for depreciation purposes in the electric car by the amount of credit claimed.

For property first placed in service after December 31, 2001, both the federal clean-fuel vehicle and refueling deduction and the federal electric vehicle credit are phased out in the three ensuing years as follows: 25% reduction in the year 2002, 50% reduction in the year 2003, and 75% reduction in the year 2004.

This bill would allow a credit in an amount equal to an unspecified percentage of the amount paid or incurred during the year to lease or purchase a new zero-emission vehicle covering a maximum of 36 months of lease or purchase payments, up to a maximum credit of $3,000 per vehicle per year. The credit shall only be allowed for new ZEVs with an original lease term or purchase that commences between January 1, 2001, and December 31, 2002.

The bill defines "zero-emission vehicle" as a light-duty vehicle certified by the California Air Resources Board as having zero tailpipe and evaporative emissions. Eligible ZEVs shall meet all federal and state safety requirements and shall have minimum three-year warranties. Eligible ZEVs shall be freeway capable, as determined by the California Air Resources Board in conjunction with the Department of Motor Vehicles (DMV).

This bill specifies that a lessee of a ZEV may make an irrevocable election to allow the lessor of the vehicle to take the credit provided under this section, provided that the lessor agrees in writing to pass-through the full value of the credit to the lessee in the form of lower lease payments. The lessor shall provide full documentation of this transaction to the lessee.

This bill specifies that the California Air Resources Board, in consultation with the DMV and the California Energy Commission, shall specify criteria and other requirements for eligibility for this credit and shall administer the determination of vehicle eligibility for the Franchise Tax Board (FTB).

This bill would allow any unused credit to be carried over until exhausted. Since this bill does not specify otherwise, the general rules in state law that apply to the division of credits among two or more taxpayers would apply.

Policy Considerations

While several state agencies are involved in the determination of what types of vehicles are eligible for the credit, the bill does not actually require the vehicle to be registered or operated in California.

The bill requires that a lessor "agree in writing" to pass through the full value of the credit to the lessee in the form of lower lease payments in order for the lessor to claim the credit where the lessee has made the election to allow the lessor to do so. However, there is no penalty to the lessor if the lessor fails to honor the contractual agreement, nor is there any effective way for the department to audit this particular provision.

The bill allows a credit on the "lease or purchase" payments made during the 36-month qualifying period, but does not specify what those payments may be comprised of. For example, lease payments ordinarily include an interest factor, as do purchase agreements, and may additionally include insurance, maintenance, repairs, and extended warranty payments. The bill should clarify which items included in the lease or purchase payments qualify for the credit.

Tax law generally focuses on the "tax ownership" of property to determine which taxpayer will be entitled to depreciation deductions and, under prior federal law, the repealed investment tax credit. Under that latter prior federal law scheme, the tax owner of the property (the lessor in a true lease, or the purchaser in the case of a finance lease or straight purchase), was the party entitled to claim the credit, although an election provision allowed a lessor of property to pass the credit through to a lessee. In contrast, this bill focuses in some instances on the tax owner of the property (purchaser), while in other instances it focuses on the user of the property (lessee). Additionally, in the case of a lease transaction, the lessor will usually be a large finance company or bank, rather than the dealer or manufacturer of the ZEV.

Implementation Considerations

This bill does not limit the number of years for the carryover. The department would be required to retain the carryover on the tax forms indefinitely because unlimited credit carryover is allowed. Recent credits have been enacted with a carryover limit since experience shows credits are typically used within eight years of being earned.

Technical Considerations

This bill proposes to add the Zero-Emission Vehicle Credit to Sections 17053.37 of the PITL and 23637 of the B&CTL; however, these sections are already used by the Credit for Joint Strike Fighter property.

FISCAL IMPACT

Departmental Costs

This bill is not expected to significantly impact the department's costs.

Tax Revenue Estimate

Based on the data and assumptions below, revenue losses are estimated as follows (assumes a 50% credit percentage):

Revenue Impact of SB 1726 For Original Lease or Purchase Beginning Between 1/1/01 and 12/31/02 Assumed Enactment After 6/30/2000 (In Millions)		
2000-1	2001-2	2002-3
Negligible Loss	-$3	-$7

- Negligible Loss = Less Than $250,000

This analysis does not consider the possible changes in employment, personal income, or gross state product that could result from this proposal.

Tax Revenue Discussion

The revenue impact of this bill would depend upon the number of taxpayers leasing or purchasing a new zero-emission vehicle, the lease or purchase cost of the vehicle, the number of vehicles purchased, the number of vehicles a lessee elects to allow the lessor to take the credit, and the average credit applied against tax liabilities.

These estimates reflect applied credits in the respective years and are based on the following data and assumptions:

- The credit (as yet unspecified) would be available on 50% of the amount paid or incurred during the taxable year to lease or purchase a new zero-emission vehicle.
- The purchase or lease of qualified vehicles must be for use in California.
- The number of zero-emission vehicles projected to be sold or leased is estimated to be approximately 1,000 for the year 2001 and 5,000 for 2002. These estimates were based on information from the Air Resources Board and a memorandum of agreement between the board and the major auto industries. By the year 2006, it is estimated that approximately 40,000 zero-emission vehicles will be produced for California by the major auto industries.
- Based on information from a study conducted by Southern California Edison, approximately 83% of zero-emission vehicles are leased and that government leases and sales represent 62% of the universe.

- The average credit for leased vehicles is estimated to be approximately $2,200 annually for three years. This is based on information obtained from the Internet regarding various lease programs and cost.
- It is not anticipated that many private lessees other than government would choose to transfer their credit in lieu of smaller lease payments.
- The average credit for purchased vehicles is estimated to be approximately $2,400 per vehicle per year. This assumes an average vehicle payment of approximately $400 per month including principal and interest. It is assumed that the amount paid or incurred during the taxable/income year represents actual payments made for the purchase or lease of the vehicle and not the entire loan amount if financed.
- Assumed that 10% of vehicles purchased would not be financed. For these individuals the average credit is estimated to be $3,000 in the year of purchase.
- The 2000-01 fiscal year loss represents approximately 10% of the loss attributable to the 2001 taxable/income year. This adjustment assumes some taxpayers would revise estimate payments to allow for the credit and takes into consideration both fiscal and calendar year filers.

In summary, for the first full year of the credit, it is projected that approximately 385 zero-emission vehicles would qualify taxpayers for the credit. The average applied credit is estimated to be approximately $2,200.

BOARD POSITION

Pending.